No. 18,203

In the United States Court of Appeals for the Ninth Circuit

ESTATE OF E. W. CHISM, Deceased, CLARA CHISM, Executrix, and CLARA CHISM, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

FILED

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 164-189) are not officially reported.

JURISDICTION

This petition for review (R. 196-200) involves federal income taxes for the years 1952 through 1956. By his notice mailed to taxpayers [1] on March 6, 1959

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[1] For convenience, Clara Chism and the estate of E. W. Chism, deceased, will be referred to collectively as the taxpayers.

(R. 10-19), the Commissioner determined deficiencies for the above years in the following amounts (R. 11):

Year	Amount
1952	$ 4,557.10
1953	3,388.92
1954	3,000.50
1955	3,233.48
1956	1,503.00
Total	$15,683.00

Within 90 days thereafter and on May 11, 1959, taxpayers filed a petition for redetermination with the Tax Court, pursuant to Section 272(a) of the Internal Revenue Code of 1939 and Section 6213 of the Internal Revenue Code of 1954. (R. 1, 3-7.) The decision of the Tax Court (R. 195), entered on April 27, 1962, affirmed the Commissioner's determination. On July 27, 1962, taxpayers filed a petition for review with this Court. (R. 196-200.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.[2]

QUESTIONS PRESENTED

Whether the Tax Court erred in holding that:

1. The withdrawals made by taxpayers from their family-owned corporation were informal dividends and not loans;

2. The assessment against taxpayers for the year

[2] The instant case was consolidated for trial with the companion case of *Chism Ice Cream Co.* v. *Commissioner*, Docket No. 80199. A petition for review was not filed in the latter case.

1952 was not barred by the statute of limitations; and

3. None of the salary received by E. W. Chism in 1952 and 1953 was excludable from gross income as amounts received under a wage continuation plan.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * *

(c) *Omission from Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

* * * *

(26 U.S.C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

* * * *

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assess-

ment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

* * * *

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 322. REFUNDS AND CREDITS.

* * * *

(b) *Limitation on Allowance.*—

(1) *Period of limitation.*—Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

* * * *

(3) [as added by Sec. 169(a), Revenue Act of 1942, c. 619, 56 Stat. 798.] *Exceptions in the case of waivers.*—If both the Commissioner and the taxpayer have, within the period prescribed in paragraph (1) for the filing of a claim for credit or refund,

> agreed in writing under the provisions of section 276(b) to extend beyond the period prescribed in section 275 the time within which the Commissioner may make an assessment, the period within which a claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, shall be the period within which the Commissioner may make an assessment pursuant to such agreement or any extension thereof, and six months thereafter, except that the provisions of paragraph (1) shall apply to any claim filed, or credit or refund allowed or made, before the execution of such agreement. * * *
>
> * * * *

(26 U.S.C. 1952 ed., Sec. 322.)

STATEMENT

The basic facts as stipulated (R. 22-29) and as found by the Tax Court (R. 167-179) may be summarized as follows:

E. W. Chism organized the Chism Ice Cream Company (hereinafter called the Company) in 1933 as successor to a sole proprietorship of the same name which he had founded in 1905. The Company engaged in the manufacture and sale of ice cream and carbonated beverages, and Chism was the president of the Company continuously from the time of its incorporation until his death on December 27, 1956. During the years 1952 through 1956, his daughter, Alice Jane Frazer, was the vice-president and his wife Clara, was the secretary of the Company. The

board of directors consisted of Chism, his wife and his daughter, and during the years in question all of the Company's issued and outstanding common stock was owned by Chism (71,500 shares), his wife (67,500 shares) and his daughter (51,000 shares). (R. 168, 169, 170.)

The following statement shows, for the years 1938 through 1958, the Company's earned surplus, the amounts of all formal dividends declared and paid, and the salaries paid to the Chism family (R. 25-26, 171, Ex. 1-A):

Year	Earned Surplus (Nearest Thousand)	Dividends declared and paid	Salaries paid (Nearest Thousand) E. W. Chism	Clara Chism	Alice Jane Frazer
1938	$ 23,000	None	$ 9,000	None	None
1939	44,000	None	9,000	None	None
1940	61,000	None	9,000	None	None
1941	61,000	None	9,000	None	$1,000
1942	93,000	None	9,000	None	1,000
1943	118,000	None	9,000	None	1,000
1944	146,000	None	9,000	None	1,000
1945	161,000	None	15,000	None	2,000
1946	166,000	$587.00	18,000	None	2,000
1947	173,000	None	18,000	None	2,000
1948	182,000	None	18,000	None	3,000
1949	215,000	None	20,000	None	4,000
1950	234,000	None	24,000	None	5,000
1951	224,000	None	24,000	None	5,000
1952	228,000	None	24,000	None	5,000
1953	267,000	None	24,000	None	5,000
1954	287,000	None	24,000	None	5,000
1955	285,000	None	24,000	None	5,000
1956	294,000	None	24,000	None	5,000
1957	309,000	None	*	$24,000	5,000
1958	314,000	None	*	24,000	5,000
1959	305,000	None	*	24,000	7,000

* Chism died on December 27, 1956.

Up until 1952, the progress and success of the Company was attributable principally to the personal

efforts of Chism. The business grew from a one-man operation at the time of its founding in 1905 to a modern, mechanized ice cream and carbonated beverage enterprise, having between 50 and 75 employees. However, after the beginning of 1952, Chism was physically incapacitated and was confined almost entirely to his home as the result of a heart ailment which began in about 1948 and which recurred in more serious form during 1951. Thereafter, he continued to be the Company's president, but his activities were confined principally to occasional visits of one-half hour or so to the Company's office, accompanied by a nurse. After 1953, he was confined entirely to his home, where from time to time he had conferences regarding business matters with the Company's general manager, Walther, who had assumed responsibility for the Company's day-to-day operations. (R. 172-173.)

Notwithstanding that Chism was incapacitated physically after 1951, and that the amount of his services to the business thereafter declined steadily, the Company continued to pay him either the same or increased amounts of salary for the years 1952 through 1956. All of the salary so paid for those years was treated by the Company as "salary" in its books and in its corporate income tax returns. (R. 173.)

During the years 1935 through 1958, Chism or his wife made numerous withdrawals from the Company, and also made certain repayments with respect thereto. These withdrawals and repayments were re-

corded in the Company's books in an account entitled "E. W. Chism—Note Receivable." Actually, no promissory notes or other written instruments evidencing such withdrawals were ever executed or delivered to the Company. Also, no interest was ever charged or paid on the outstanding balance, and no collateral security therefor was ever given. (R. 173-174.) The total withdrawals and repayments were as follows (R. 174, Ex. 2-B):

Year	Withdrawals	Repayments	Balance
1935–1946	$43,017.77	$24,090.95	$18,926.82
1947	------	------	18,926.82
1948	6,584.45	1,200.00	24,311.27
1949	1,500.00	------	25,811.27
1950	1,500.00	2,803.25	24,508.02
1951	7,500.00	1,720.17	30,287.85
1952	10,046.90	------	40,334.75
1953	7,821.16	------	48,155.91
1954	10,213.88	------	58,369.79
1955	12,565.81	------	70,935.60
1956	7,300.00	------	78,235.60
1957	------	------	78,235.60
1958	------	78,235.60*	

* The "repayment" shown for the year 1958 was made by the estate of E. W. Chism, as hereinafter shown.

All of the withdrawals were made informally, and they were not earmarked by the Company for application to medical expenses. There is no indication on the Company's books or elsewhere that the payments were made pursuant to any health insurance plan. The employees of the Company were not notified or advised of the existence of any such plan, nor did they have any right to demand benefits under a plan. (R. 174-175.)

Sometime prior to April, 1957, a revenue agent, who was examining the returns of the taxpayers and the Company for the years here involved, discussed with the Company's accountant the possibility of treating the withdrawals for those years as informal dividends. The accountant then discussed this matter with Chism's wife and Walther, and it was the accountant's feeling that something should be done to "clean up" the balance in the above-mentioned account. Thereafter, on April 25, 1957, the Company filed a claim, signed by Mrs. Chism as secretary of the Company (Ex. 5), against the estate of E. W. Chism for the amount of the then outstanding balance of $78,235.60 in the account. The claim was approved by Mrs. Chism as executrix of the estate (Ex. 5), and subsequently allowed by the probate court in Reno, Nevada. The amount of the claim, without interest, was paid in full to the Company by the estate on October 20, 1958. (R. 175.)

The Company did not at any time have any formal plan of "health insurance" for its officers or employees, nor did it have any formal salary or wage continuation plan. However, it did on seven occasions during the 20-year period of 1941 through 1960 pay all or part of the wages of employees who were temporarily ill or who had surgical operations. In all of these cases except two, the amounts paid as wages to the employee during his illness ranged from $449 to $875, and in the other two cases the amounts so paid were respectively, $2,650 and $4,770.39. (R. 175-176, Ex. 9.)

Chism and his wife filed their joint income tax return for the year 1952 on March 14, 1953, wherein they reported gross income in the amount of $25,-141.37. (R. 178, Ex. 6-D.) This amount did not include any portion of the $10,046.90 withdrawn from the Company that year which the Commissioner and the Tax Court determined to be includible in their gross income for the year as "informal dividends". On November 13, 1957, which was more than three but less than five years after the filing and due date of the return, Mrs. Chism, acting both individually and as executrix of Chism's estate, entered into a consent agreement (Treasury Form 872) with the Commissioner, under which the time for making any assessment for the year 1952 was extended to June 30, 1959. (R. 178, see Ex. 6-D.) The deficiency notice pertaining to the years 1952 through 1956 was issued on March 6, 1959. (R. 10, 178.)

At the completion of the trial, the Tax Court made the following ultimate findings (R. 178-179):

1. Reasonable allowances to the Company for salaries paid to Chism for the years 1953, 1954, 1955, and 1956 were $20,000, $15,000, $12,000 and $12,000, respectively.

2. The withdrawals made by Chism and his wife from the Company during the years 1952 through 1956 constituted informal dividends.

3. The Company did not have a health insurance plan in effect during any of the years here involved.

4. The deficiency assessment against Chism and his wife for the year 1952 was not barred by the statute of limitations.

On the basis of the above findings, the Tax Court held (R. 186) that the withdrawals were includible in the gross income of Chism and his wife as informal dividends and were not excludable therefrom either as loans or as health insurance plan payments. The Tax Court also rejected (R. 182, 189) taxpayers' arguments (1) that part of the salary received by Chism in 1952 and 1953 was excludable from his gross income as amounts received under a wage continuation plan and (2) that the assessment against Chism and his wife for 1952 was barred by the statute of limitations.[3]

SUMMARY OF ARGUMENT

1. Whether withdrawals from a corporation by a stockholder are dividends or loans has uniformly been held to be a question of fact to be decided on consideration of all the circumstances. In the instant case it is readily apparent that Chism treated the earnings of the ice cream company as his own by withdrawing substantial amounts therefrom on open account over a period of approximately 25 years, resulting in an outstanding balance in the account in

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[3] In the companion case of *Chism Ice Cream Co.* v. *Commissioner,* the Tax Court held (1) that the excessive compensation paid to Chism was not deductible by the Company either as salary or health insurance payments and (2) that the premiums paid by the Company on a retirement income policy covering the life of its general manager were not deductible by the Company because it was the "direct beneficiary" of the policy. No appeal was taken from that decision.

the amount of $78,235.60 as of the end of 1956. The relevant facts overwhelmingly support the finding of the Tax Court that the withdrawals were dividends and not loans.

There were no notes given, no interest was charged and no collateral was required. The withdrawals were substantial, and any repayments occasional and insubstantial, with no repayments at all being made during the five years in question. There was no evidence of any intention on his part to repay the withdrawals, nor did the Company at any time during his life take steps to enforce payment. The corporation's stock was owned entirely by Chism and his immediate family and his control of the corporation was reinforced by the fact that his wife and daughter were officers and directors of the corporation. Finally, even though the corporation's earned surplus exceeded $200,000 during the years in question, no formal dividends were ever paid or declared.

The fact that the Company's claim for the outstanding balance was allowed against Chism's estate by the local probate court after an examination of his returns by a revenue agent had begun did not preclude the Tax Court from determining his tax liability. A nonadversary proceeding in a state court which is collusive in the sense that the parties seek to adversely affect the Government's right to additional income taxes is not binding on the federal courts.

2. The special five-year period of limitations applies to taxpayers' 1952 return because they failed to report more than 25 percent of their gross income

therein. Moreover, prior to the expiration of the five-year period, taxpayers consented to an extension of time within which the Commissioner could assess a deficiency. The Commissioner's deficiency notice was within the extended period and was not barred by the statute of limitations. Taxpayers argument that the consent agreement is invalid because it did not also extend the time within which a claim for refund could be filed is unsupported by authority and is manifestly without merit.

3. The Tax Court's finding that the ice cream company did not have a health or wage continuation plan for its employees is not clearly erroneous. The payments made to Chism by the Company were not earmarked or treated as health payments by the Company, but were carried on the books as "salary" and deducted as such in the Company's income tax returns. Employees were not advised of the existence of a plan and had no right to demand benefits under any such plan. Whether or not payments would be made, and the amount and duration thereof, was within the discretion of the Company's management and could be changed at will. The fact that the Commissioner mistakenly allowed a deduction for wage continuation payments for the years 1954 through 1956 does not mean that a plan existed during those years or during any prior years. The Commissioner does not concede the existence or accuracy of the facts upon which deductions are based by accepting or acquiescing in tax returns.

ARGUMENT

I

The Finding of the Tax Court That the Withdrawals Were Dividends and Not Loans Is Not Clearly Erroneous

The main question on this appeal is whether the Tax Court erred in holding that the withdrawals by E. W. Chism from the family-owned corporation were in fact dividends and not loans. Since this is a question of fact to be determined upon a consideration of all the circumstances present in a particular case, the lower court's decision should not be disturbed unless it is clearly erroneous. *Clark* v. *Commissioner*, 266 F. 2d 698 (C.A. 9th); *Roschuni* v. *Commissioner*, 29 T.C. 1193, affirmed *per curiam*, 271 F. 2d 267 (C.A. 5th); *Regensburg* v. *Commissioner*, 144 F. 2d 41 (C.A. 2d), certiorari denied, 323 U.S. 783.[4]

In determining whether a withdrawal is a loan or a dividend, numerous factors are relevant although no one of them may be controlling. The factors generally considered by the courts are as follows: (1) whether the corporation is closely held and controlled (*Roschuni, supra; Baird* v. *Commissioner*, 25 T.C. 387; *Wilson* v. *Commissioner*, 10 T.C. 251, affirmed, 170 F. 2d 423 (C.A. 9th)); (2) whether notes are given and interest charged (*Clark* v. *Commissioner, supra; Oyster Shell Products Corp.* v. *Commissioner*,

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[4] See Section 7482(a), Internal Revenue Code of 1954; Rule 52(a), Federal Rules of Civil Procedure; *Commissioner* v. *Duberstein*, 363 U.S. 278, 289; *Wentworth* v. *Commissioner*, 244 F. 2d 874 (C.A. 9th).

(C.A. 2d), decided February 13, 1963 (11 A.F.T.R. 2d 777); *United States* v. *E. Regensburg & Sons*, 221 F. 2d 336, 337 (C.A. 2d)); (3) whether collateral is given to secure the purported loans (*Levy* v. *Commissioner*, 30 T.C. 1315; *Crispin* v. *Commissioner*, 32 B.T.A. 151); and (4) whether the withdrawals are periodic and at will with a steadily mounting balance (*Regensburg* v. *Commissioner, supra; Baird* v. *Commissioner, supra; Meyer* v. *Commissioner*, 45 B.T.A. 228). Other factors relevant, depending upon the circumstances of each case, are whether there is a definite time for repayment or a ceiling on the amount that can be withdrawn; whether there is any effort to enforce collection on the part of the company or any plan for repayment by the stockholders; and whether the corporation has customarily declared and paid formal dividends. See *Niederkrome* v. *Commissioner*, 266 F. 2d 238 (C.A. 9th); *Wiese* v. *Commissioner*, 93 F. 2d 921 (C.A. 8th), certiorari denied, 304 U.S. 562; *Spheeris* v. *Commissioner*, 284 F. 2d 928 (C.A. 7th); *Goodman* v. *Commissioner*, 23 T.C. 288; *Simmons* v. *Commissioner*, 26 T.C. 409; *Kinnear* v. *Commissioner*, 36 B.T.A. 153; *Mellon* v. *Commissioner*, 36 B.T.A. 977; *Murchison* v. *Commissioner*, 32 B.T.A. 32; *Marshall* v. *Commissioner*, 32 B.T.A. 956; *Hunt* v. *Commissioner*, 6 B.T.A. 558; 1 Mertens, Law of Federal Income Taxation (Rev.), Sec. 9.21.

A. *Substantial evidence supports the decision*

In the instant case, the opinion of the court below (R. 164-189) recites more than enough facts to support its decision. In the first place, the taxpayers,

along with their daughter, controlled the corporation: Chism was president of the Company, his daughter was vice president, and his wife was the secretary; all three comprised the board of directors, and all three owned all the issued and outstanding stock of the Company. (R. 168-170.) In the second place, the withdrawals were continuous, substantial and apparently in whatever amounts the taxpayers desired. (R. 174.) In the third place, no notes were given for the amounts received, no interest was charged, and no security was given. (R. 174.) In the fourth place, this practice continued for a period of 22 years, and the net amount of withdrawals increased steadily and in considerable amounts, totalling $78,235.60 by the end of 1956.[5] (R. 174.) In the fifth place, even though the Company's earned surplus was in excess of $100,000 beginning in 1943, and over $200,000 during the years involved, no formal dividends were ever declared or paid, with the ex-

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[5] In an analogous situation, in *Baird* v. *Commissioner, supra,* the Tax Court stated the following (p. 394):

> The fact that the individual debit balances were allowed to mount steadily each year without any substantial repayment thereon for more than 20 years until they reached a total net withdrawal balance of approximately $98,000 *is inconsistent with an intent to borrow and repay.* * * * The tax saving which would result, if petitioners' techniques were approved, is obvious, and the motive is by the same token apparent. [Emphasis added.]

See to the same effect, *Regensburg* v. *Commissioner, supra; Roschuni* v. *Commissioner, supra.*

ception of a $587 dividend in 1946.[6] (R. 171.) In the sixth place, there was no arrangement to repay the ever-increasing balances in fixed amounts or at a definite time in the future, nor did the Company, at any time during Chism's life, take any steps to enforce repayment. (R. 185.) Finally, repayments were unsubstantial and sporadic, with no repayments at all being made during the years in question. (R. 174.)

The foregoing, fully supported by the record, presents an overwhelming picture of the owners of a family corporation siphoning off corporate earnings for their own personal use without any plan of reimbursement.

Taxpayers' argument (Br. 14-30) that the withdrawals were "loans" does not merit extended discussion. The balance in the drawing account was paid in full by Chism's estate in 1959, but this was done only after a revenue agent had suggested the possibility of treating the withdrawals as dividends. (R. 185-186.) It is the intention at the time the withdrawals are made which is determinative (*Clark* v. *Commissioner*, *supra*), and that intention cannot be conveniently changed by subsequent events. Courts view with a jaundiced eye the repayment of the alleged debts after an examination of the returns has begun. See, *Regensburg* v. *Commissioner*, *supra;* *Roschuni* v. *Commissioner*, *supra;* *Baird* v. *Commis-*

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[6] The only other formal dividends paid in the history of the Company were during 1936 and 1937 (R. 25), and these, according to Mr. Walther (R. 77) were prompted by the undistributed profits tax in effect at that time.

sioner, supra; Meyer v. *Commissioner, supra; Continental Machine & Tool Corp.* v. *Commissioner*, decided April 25, 1962 (1962 P-H T.C. Memorandum Decisions, par. 62,096).

The only evidence of an intention to repay is the vague and inconclusive testimony of Mrs. Chism (R. 102-103, 109), which falls far short of establishing a plan or intention of repaying. At most, the record supports no more than a conclusion that taxpayers "hoped to" (R. 103) repay the withdrawals, although they did not have the money to do so. (R. 109). The absence of resources with which to repay the withdrawals was held to be a relevant fact in the *Baird, Meyer, Regensburg* and *Marshall* cases, *supra.*

The fact that the withdrawals were designated on the Company's books and financial statements as loans is not enough to establish the character of the withdrawals (*Clark* v. *Commissioner, supra*), nor is it significant that the withdrawals were not strictly proportionate to stock holdings (*Roschuni* v. *Commissioner, supra*), especially since the stockholders here are all in the same family.

The practice indulged in by the taxpayers, of continuously withdrawing amounts on open account over a substantial period of time with an ever-increasing balance, is readily recognized by the courts as " 'an established method of dividend distribution' " in closely held corporations. *Regensburg* v. *Commissioner, supra*, p. 44.

B. *The Tax Court was not bound by the order of the probate court*

The fact that the Company's claim against Chism's estate for the amount of the outstanding balance in the withdrawal account was allowed by the probate court of Washoe County, Nevada, as a debt of the estate did not preclude the Tax Court from deciding that, for federal tax purposes, the withdrawals should be classified as dividends and not loans, because the judgment of the Probate Court was not entered in a bona fide adversary proceeding after a hearing on the merits and because it was collusive in the sense that the parties sought a decision which would adversely affect the Government's right to additional income taxes. This rule was succinctly stated by this Court in *Wolfsen* v. *Smyth*, 223 F. 2d 111, 113-114:

> This court recently held in *Newman* v. *Commissioner of Internal Revenue*, 222 F. 2d 131, that an order of a state court that adversely affects the tax right of the United States and which is based upon a nonadversary proceeding, does not foreclose the federal courts from determining the tax liability.

To the same effect, see *Estate of Rainger* v. *Commissioner*, 183 F. 2d 587 (C.A. 9th), affirming *per curiam* 12 T.C. 483.[7]

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[7] See also, *In re Sweet's Estate*, 234 F. 2d 401, 404 (C.A. 10th), certiorari denied, 352 U.S. 878; *Faulkerson's Estate* v. *United States*, 301 F. 2d 231 (C.A. 7th), certiorari denied, 371 U.S. 887; *Brainard* v. *Commissioner*, 91 F. 2d 880, 883-884 (C.A. 7th), dismissed, 303 U.S. 665; *Stallworth's Estate* v. *Commissioner*, 260 F. 2d 760, 763 (C.A. 5th);

The claim filed on behalf of the Company was signed by Mrs. Chism as secretary of the Company, and was approved for repayment on behalf of the estate by Mrs. Chism acting as executrix thereof. (R. 185, Ex. 5.) The result is a classic example of a consent decree. Moreover, since the claim was filed after a revenue agent had examined the returns and suggested the possibility of treating the withdrawals as dividends (R. 185-186), it can reasonably be inferred that the proceeding was "collusive in the sense that all parties in effect * * * sought a decision which would adversely affect the Government's right to additional income tax." *Freuler* v. *Helvering*, *supra*, p. 45; *Wolfsen* v. *Smyth*, *supra*, pp. 113-114.

None of the cases cited by the taxpayers (Br. 17-29) support their contention that the Tax Court was conclusively bound by the order of the probate court (Ex. 5) which allowed as a debt the Company's claim against Chism's estate for the balance shown in the withdrawal account.

In *Blair* v. *Commissioner*, 300 U.S. 5, there was an adversary proceeding on the merits between the trustees and the beneficiary with no "basis for a charge that the suit was collusive * * *" (p. 10). In *Freuler* v. *Helvering*, 291 U.S. 35, 45, the Court noted that "The decree purports to decide issues regularly submitted and not to be in any sense a

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Saulsbury v. *United States*, 199 F. 2d 578, 580 (C.A. 5th); *Regensburg* v. *Commissioner, supra; Cenedella* v. *United States*, 224 F. 2d 778 (C.A. 1st); *Freuler* v. *Helvering*, 291 U.S. 35.

consent decree" and held further that the state court proceedings were *not* "collusive".

This Court's decision in *Henricksen* v. *Baker-Boyer Nat. Bank*, 139 F. 2d 877 is not in point. There, the state court decree, interpreting the meaning and effect of a will, was rendered upon a consideration of the merits in an adversary proceeding with no evidence of collusion in the sense that the parties sought to adversely affect the tax rights of the Government. The rule in this Circuit, which controls the disposition of the instant case, is stated in the *Wolfsen* and *Rainger* cases, *supra*, and in *Newman* v. *Commissioner*, 222 F. 2d 131 (C.A. 9th).

Taxpayers cite the Third Circuit case of *Gallagher* v. *Smith*, 223 F. 2d 218, as authority for their contention that the federal courts are conclusively bound by decrees of inferior state courts "whether or not they are adversary." (Br. 24.) We know of no reported case which so holds and, moreover, it is clear that the Third Circuit did not enunciate such a principle of law. The Third Circuit expressly qualified the language of its opinion as follows (pp. 224-225):

> Whatever may be the case with respect to consent decrees, however, it is clear that if the question is *fairly presented* to the state court for its *independent decision and is so decided* by the court the resulting judgment if binding upon the parties under the state law is conclusive as to their property rights in the federal tax case, regardless of whether they occupied adversary positions in the state court or were all on the same side of the question. [Emphasis added.]

Furthermore, *Gallagher* does not hold that every nonadversary proceeding in an inferior court, *ipso facto*, forecloses any inquiry by the federal courts as to the validity of the decree; the court stated immediately following the above quotation (p. 225):

> It is clear, as suggested by the Supreme Court in the *Freuler* and *Blair* cases, that a state judgment obtained by *collusion to defeat a federal tax need not be given conclusive effect* in a suit in a federal court involving that tax. And the *nonadversary character of a state suit is undoubtedly relevant as evidence of such collusion.* [Emphasis added.]

Even under *Gallagher*, therefore, the Tax Court was not conclusively precluded from determining the tax liability involved here.

It is readily apparent that the claim against Chism's estate was a mere afterthought and an obvious attempt by taxpayers to extricate themselves from the tax consequences of their past actions. Their contention now, that the Tax Court was bound by the order of the probate court, is unsupported by authority.

To sum up, all that the taxpayers have come up with to meet their affirmative burden of showing that the Tax Court's decision is clearly erroneous is that the net balance in the withdrawal account was paid by Chism's estate after the revenue agent suggested treating the withdrawals as dividends, some general testimony by Mrs. Chism that she "hoped to" repay the amounts, and the fact that the withdrawals were designated as loans on the Company's books and

financial statements. On the other hand, it would be difficult to find a stronger array of relevant facts than those recited by the court below to show that the withdrawals were in fact the distribution of earnings and profits of the corporation, and not loans.

II

The Assessment Against Taxpayers for the Year 1952 Was Not Barred By the Statute of Limitations

Under the 1939 Code, the Commissioner has three years from the date the return is filed within which to assess a deficiency. Sec. 275(a) of the 1939 Code, *supra.* However, if the taxpayer omits from his return more than 25 percent of the gross income properly includible therein, then the Commissioner has five years from the date the return is filed within which to assess a deficiency. Sec. 275(c) of the 1939 Code, supra. In either case, the period of limitations may be extended by written waiver executed by the taxpayer within the statutory or any extended period of limitation. See Section 276(b), *supra.*

The five-year period of limitations applies in the instant case because the taxpayers omitted more than 25 percent of their gross income from their 1952 return. (R. 188.) Furthermore, prior to the expiration of the five-year period, Mrs. Chism, acting both individually and as executrix of Chism's estate, entered into a consent agreement with the Commissioner under which the period for assessment of the deficiency for the year 1952 was extended to June 30, 1959. (R. 188-189, Ex. 6-D.) The Com-

missioner's deficiency notice, issued on March 6, 1959 (R. 10, 27), was within the extended period and is clearly not barred by the statute of limitations. *Azevedo* v. *Commissioner*, 246 F. 2d 196 (C.A. 9th).

Taxpayers' argument (Br. 38-44) that the consent signed by Mrs. Chism is invalid because it lacked "mutuality" is without substance. A consent agreement extending the time within which the Commissioner may make an assessment also extends the time within which a claim for refund may be filed *provided* the consent is signed within the period prescribed by Section 322(b)(1), *supra*, namely, within three years from the time the return was filed or within two years from the time the tax was paid, whichever is later. See Sec. 322(b)(3) of the 1939 Code, *supra*.[8] Since the consent was not filed prior to March 15, 1956 (three years from the date the return was filed), but rather on November 13, 1957 (R. 27), the taxpayers were not entitled to an extension of time within which to file their refund claim for 1952. There is no provision comparable to Section 322(b)(3) for consents signed *after* the period of time provided in Section 322(b)(1); taxpayers' argument that there *should be* is best addressed to Congress rather than the courts.

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[8] Here, the return is considered filed and the tax paid on March 15, 1953. See Treasury Regulations 118 (1939 Code), Sec. 39.322-7(b).

III

None of the Salary Received By Chism In 1952 and 1953 Is Excludable From Gross Income As Amounts Received Under a Wage Continuation Plan

As noted above, the instant case involving Chism and his wife was consolidated for purposes of trial with a companion case involving the family-owned corporation, i.e., the Chism Ice Cream Company.[9] In the companion case, the Company sought, among other things, to deduct the full amount of salary paid to Chism during the years 1953 through 1956 on the grounds that the amounts constituted reasonable compensation or, in the alternative, that if some of the salary was unreasonable, then all or part of the excess salary was deductible as "health insurance payments." (R. 166.) The Tax Court found that of the salary paid, the following amounts were excessive and not deductible, being, in essence, "informal dividends" to Chism and his wife as stockholders (R. 171, 178, 179, 181):

1953	$ 4,000
1954	$ 9,400
1955	$12,210
1956	$12,210

The court also found (R. 175, 179) that the Company did not have a health insurance plan or a wage continuation plan in effect during any of the tax

[9] Taxpayers' charge of an inconsistency in the Tax Court's findings in that case is baseless on its face, since it recognizes and quotes the court's distinction between formal dividends and informal dividends (Br. 30-31) before attempting to ignore that distinction (Br. 32).

years involved and, accordingly, rejected the Company's alternative argument that the excessive compensation was deductible as health insurance payments.

In the instant case, Chism and his wife contended below that the withdrawals were excludable from gross income either as loans or as health insurance plan payments. The Tax Court held that the withdrawals constituted informal dividends, rejecting taxpayers' argument that they were excludable either as loans or as health benefits.

Taxpayers now argue (Br. 44-48) that the Tax Court's finding that the Company did not have a health insurance plan or a wage continuation plan is clearly erroneous, and that at least $5,200 of the salary received by Chism in each of the years 1952 and 1953 should be excludable from gross income as amounts received under a wage continuation plan. This contention is without merit because the Tax Court's finding that no plan existed is amply supported by the record.

For instance, none of the payments made to Chism during the years involved were earmarked by the Company for application to medical expenses. Nor is there any indication on the Company's books or elsewhere that the payments were made pursuant to any health plan. (R. 174-175.) On the contrary, the amounts were reflected on the Company books and records as "salary" (R. 24, Ex. 1-A) and deducted as such on the Company's income tax returns (Ex. 8-F). Mr. Walther testified (R. 78) and the Tax Court found (R. 175) that the employees of the

Company were never notified or advised of the existence of a health or wage continuation plan, nor did they have any right to demand benefits under any such plan. If any rights existed, they could be varied at will by management. (R. 78.)

To support their contention that a plan existed in 1952 and 1953, taxpayers argue (Br. 44) that the Commissioner "conceded" the existence of a plan for the years 1954 through 1956 because he failed to disallow the deductions taken in those years for amounts claimed to have been received under a wage continuation plan. (See Ex. 7-E.) However, taxpayers cite no authority, nor can any be found, for the proposition that by accepting a tax return the Commissioner *concedes* the existence or accuracy of certain facts upon which the deductions are based. It is well known that mere acceptance of or acquiscence in tax returns for prior years creates no estoppel against the Commissioner (*Niles Bement Pond Co.* v. *United States*, 281 U.S. 357; *Caldwell* v. *Commissioner*, 202 F. 2d 112 (C.A. 2d)), nor does it preclude him from reaching a different conclusion for the current year either on questions of law or questions of fact (*Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180). The rationale of the estoppel cases precludes the mere acceptance of tax returns from being considered a concession by the Commissioner.

Finally, the fact that the Company may have paid half-time or full-time wages for limited periods to some seven employees during its 27 years of existence (see Ex. 9) does not elevate an apparently dis-

cretionary policy to the dignity of a *plan* for federal tax purposes. See *Haynes* v. *United States*, 353 U.S. 81, and *Epmeier* v. *United States*, 199 F. 2d 508 (C.A. 7th), for examples of informal plans prior to the 1954 Code.

It is apparent from the record as a whole that taxpayers here sought to siphon off the earnings of their family-owned corporation in the form of salaries and so-called "loans," in an attempt to reduce taxes, both to the Company by means of a deduction for salaries and to themselves by treating the withdrawals as loans. Their argument now, that the "informal dividends" which they received in the form of excessive compensation and so-called "loans" were in fact amounts received pursuant to a health or wage continuation plan, is patently without substance.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated........................day of....................................., 1963.

....
Attorney

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